

The Wall Street-Main Street Nexus in Financial Regulation: Business Coalitions Inside and Outside the Financial Sector in the Regulation of OTC Derivatives

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What is the role of private sector groups in informing the incremental character of the financial regulatory response to the recent crisis? As Moschella and Tsingou argue in the introductory chapter, the influence of those business actors that are advantaged by the existing institutions and have a vested interest in the continuation of the status quo represents a primary determinant of patterns of incrementalism in regulatory politics. Studies that have explored these dynamics in the financial regulatory arena have often unequivocally identified in the financial industry groups as the primary “veto players”, frequently deploying a variety of strategies and resources in order to oppose significant attempts at regulatory reform that could generate a regulatory burden and place them at a competitive disadvantage. From this perspective, the paucity of significant regulatory reforms which challenge the prevalent paradigm represents a sign of the consistent power of the same financial industry groups that drove much of the deregulatory policies before the crisis and the continued political resiliency in their capacity to veto more ambitious regulatory solutions.

In this chapter we contend that while financial industry groups have played an important role in shaping post-crisis regulatory reform, this influence has remained conditional on their capacity to adjust their advocacy strategies in response to the changes in the new regulatory environment triggered by the crisis. As the crisis has weakened the capacity of the financial industry groups to preserve the status quo by usual means, the capacity of financial industry to shape the content of regulatory policies has been increasingly determined by their capacity to tie their interests to those of a broader range of stakeholders outside of the financial industry.

Consequently, in order to explain the incremental nature of the post-crisis regulatory response, we need to consider not just the financial industry groups being directly subjected to regulation, but also the mobilization of non-financial business groups. Such a perspective, we argue, helps to understand how a broader range of actors beyond the ‘usual suspects’ of financial sector groups themselves have worked to ‘veto’ more radical regulatory solutions challenging the existing paradigm, as these measures would also

have affected the patterns of financial intermediation more broadly within the real economy. Thus rather than ‘Wall-Street’ acting as a veto player to block more ambitious post-crisis reform, the incremental nature of the regulatory reforms introduced after the crisis must be understood from the broader demands of the broader business community often working in tandem with financial groups, what could be called ‘Wall-Street-Main-Street’ complex.

The chapter is structured as follows. Section 1 discusses the prevalent ways of thinking about private financial industry groups and their power in the policymaking process. These are contrasted with the advocacy strategy employed by the financial industry during and shortly after the crisis. Section 2 discusses the role of non-financial actors within the business community and presents recent evidence of their importance in shaping the regulatory response to the global crisis. We then illustrate these dynamics at work in a high-profile, high stakes case of financial regulatory policymaking in Section 3: the reform of derivatives markets in the United States.

Our analysis thus engages with a specific dimension of Moschella and Tsingou’s framework mapped out in their Table 1 – specifically the role of private sector groups as veto players who adapt to new challenges. While our empirical case study focus is situated at the national level, in the United States, our analysis has broader implications. Indeed, the changes in private sector advocacy discussed in this chapter have informed regulatory changes at the global, regional and national levels of governance, as well as in the regulation of a broader range of sectors.

Section 1: Financial Industry Groups: Still a Dominant Veto Player?

As Moschella and Tsingou have argued in the introduction to this volume, the output of financial regulatory bodies at the national, regional and global levels have mostly fallen short of bringing a paradigm change and have been significantly less dramatic than the size and severity of the crisis might suggest. One of the most popular interpretations of this stylized fact involves the role of the financial industry as a kind of informal ‘veto player’, which blocks or at least severely limits the extent of post-crisis regulatory

reforms. Such a sentiment is crystallized in the news media's discussion of the uneven reform process in the regulation of the derivatives sector, which explains that "[b]ig banks have been lobbying to block change" (New York Times 2010); that big banks have pursued a "strangle it in the womb" strategy, leading to the result that "most of [the proposals in new regulation] them wound up whittled down to such an extreme degree that they were barely recognizable in the end" (Taibbi 2012: 65). Other accounts portray a similar general narrative of the 'big bank lobby' as voracious as ever (Kroll 2010), or depict 'Wall Street' making an 'assault...on new regulation' (Protesse and Eavis 2012). Such sentiments also exist among academic circles commenting on the issue of post-crisis regulatory reform. Acemoglu and Johnson (2012) have argued for instance that after the crisis the Fed 'has given way completely, at the higher level and with disastrous consequences, when the banker bring their influence to bear' by "resisting attempts to raise capital requirements by enough to make a difference".

Such sentiments continue a longstanding tradition within academic scholarship of identifying financial industry groups one of the primary veto players in the financial regulatory arena, capable to steer the direction of domestic and international financial regulatory reforms away from measures that could undermine their privileged position (Underhill 1995; Wood 2005; Wade 2008). Different resources have been identified by the existing scholarship as bolstering this veto power. While some scholars have focused on the financial resources deployed by financial industry groups in the policymaking process in the period before the crisis (e.g. Igan, Mishra, and Tressel 2010), other authors have argued that the capacity of the financial industry to veto regulatory policies was amplified by the same institutional context in which financial regulatory policies were developed over this period. In particular, the 'Olympian distance' of financial regulatory authorities from domestic political dynamics has been described as disguising the deep and institutionalised engagement these agencies had developed with the financial industry groups, reinforced by the shared similar 'professional ecologies', ideas, and the so-called 'revolving doors' between individuals from the industry and regulatory personnel (Underhill and Zhang 2003, Seabrooke and Tsingou 2009, Underhill and Zhang 2008, Braun and Raddatz 2009). Finally, different authors have highlighted the capacity of

financial industry groups to shape regulatory policies through their ‘cultural capital’ and the attitude prevailing in countries such as the United States ‘that what was good for Wall Street was good for the country’ (Johnson 2009; see also Kwak, forthcoming). As Johnson argues that ‘from this confluence of campaign finance, personal connections, and ideology there flowed, in just the past decade, a river of deregulatory policies that is, in hindsight, astonishing’ (Johnson 2009).

Such a perspective would suggest that the incremental change that characterizes the regulatory response to crisis can be attributed to the continuation of the power of private financial industry groups with a vested interest in preserving the status quo. Indeed, different scholars and commentators have warned of the fact that the crisis has not undermined that the influence that the same ‘Wall Street-Treasury Complex’ that drove much of the deregulatory policies before the crisis (Bhagwati 2008; Wade 2008; Johnson 2009; Tsingou 2009). For authors such as Johnson (2009), this particular situation ‘gives the financial sector a veto over public policy, even as that sector loses popular support’. As Moschella and Tsingou have argued in the introduction to this volume, the composition of veto players and change agents can be fluid based on changing circumstances. While it is true that several of the protagonists of the regulatory process before the crisis have played important roles in charting the regulatory response, works postulating the continuous dominance of financial industry groups have arguably paid insignificant attention to changes in the policymaking context since the financial crisis, and the impact that these changes had in weakening the capacity of the financial industry to veto regulatory policies. There are a number of significant factors in this regard. First, the identification of the roots of the crisis in core countries such as the US has altered the international political landscape within which the international regulatory response to the crisis has unfolded in a way less conducive to the continuation of the status quo. In the aftermath of the previous major episodes of financial instability emerging from peripheral countries (e.g. Mexican crisis of 1994; East Asian Crisis of 1997-98; Argentine crisis of 2001) US authorities had worked to narrow down the scope of more ambitious regulatory initiatives that would undermine the competitive position of their domestic financial industry, often swaying the international approach towards

market-based regulatory mechanisms (see Wood 2005; Drezner 2007). However, the origin of the crisis within the US has altered the incentives of US policymakers. Rather than acting as an international veto player on new regulatory initiatives, US authorities have been at the epicenter of efforts to re-regulate different markets and institutions domestically and internationally (Helleiner and Pagliari 2009; Fioretos 2010).

Besides the changed international political context in which the regulatory response to the crisis has unfolded, the crisis has also altered the intellectual landscape in a way detrimental to financial industry groups' traditional advocacy strategies. Unlike previous episodes financial instability of the late 1990s whose roots lied partly in fiscal imbalances, macroeconomic policies, and other government policies, the origin of the crisis in the activities of financial institutions has weakened the legitimacy of measures relying on the capacity of markets to self-discipline themselves advocated in the aftermath of the emerging market crises of the late-1990s. These ideas have been challenged by some of the same important members of the international regulatory community that had championed them before the crisis (Foot and Walter 2010: 249). This shift in the ideational landscape has therefore reduced the capacity of financial firms to rely on claims regarding the superiority of market-based solutions in order to oppose more stringent forms of regulation.

Third, the financial crisis altered the institutional context in which financial regulatory policies have been designed. While the influence of financial industry groups before the crisis was magnified by the privileged access to independent regulatory agencies and the insulation of this policy community from the 'rough and tumble of traditional policy making in democratic governments, such as in trade negotiations' (Underhill and Zhang 2008: 544; Underhill 1995), the deepening of the crisis moved the focal point away from the technocratic policy network and toward the agenda of elected politicians. The greater involvement in the design of financial regulatory reform initiatives of bodies such as the US Congress and the European Parliament has opened new access points in the policymaking process to a broader range of stakeholders. Moreover, while before the crisis lawmakers in bodies such as the US Congress had in several instances taken the side of the financial industry and rejected the calls for more stringent regulation (Tett 2009), the significant backlash against the financial industry generated by the crisis and

the deployment of taxpayer money in support of the financial industry in most industrialised countries have weakened the willingness of elected in these countries, including the US, to openly stand up in defense of the interests of the financial industry. Furthermore, the greater salience of financial regulatory issues in the US and other industrialised countries has created a political environment in which a greater number of policymakers have sought to extract electoral rewards by supporting tougher regulations of the financial industry (Helleiner and Pagliari 2011).

Thus there are a number of reasons why the institutional context in which regulation has been generated might have weakened financial industry's veto power relative to the past. This does not mean that financial industry groups have not played a meaningful role in shaping the direction of the post-crisis regulatory reforms and its incremental nature. However, the influence of financial industry groups over the design of regulatory policies has become more *conditional* on the capacity of financial sector groups to adjust their advocacy strategies in order to face the changes in the regulatory environment described above.

As Tsingou and Moschella write, when actors are faced with significant changes to the normal conditions that they operate within, they may realise that advantage is better preserved by adapting existing rules and institutions rather than seeking to maintain the status quo as such (see also Scharpf 2000: 782). This pattern has also informed the behavior of financial industry groups in the aftermath of the crisis. With their sector's mishaps in the public spotlight, financial institutions have often found it strategically counterproductive to actively and aggressively resist calls for (re)regulation of their activities. Rather than simply trying to act to veto new regulatory policies, financial industry groups have since the very early phases of the crisis sought to provide careful *support* for incremental changes in the existing regulatory regime.¹ This 'change agent'

¹ For instance, unlike the aggressive lobbying by the banking industry in the early 2000s against some proposals by the Basel Committee (see Lall 2011; Wood 2005), bank industry groups since the crisis have taken on a different tenor, often endorsing new regulatory reforms rather than resisting them (IIF 2008a; IIF 2008b). Hedge fund associations have endorsed the same requirements forcing managers to register with securities regulators that they had opposed and successfully fought in court in the years before the crisis (MFA 2004, MFA 2009, Helleiner and Pagliari 2009). Under regulatory scrutiny more than ever since the

behavior reflected the acknowledgment that seeking to preserve the status quo at all costs would have damaged the public reputation of the sector in a moment in which public opinion is not on their side, potentially leading them to being excluded from the financial policy network.² Moreover, the support for incremental regulatory changes has allowed financial industry groups to concentrate their opposition on those elements of the emerging regulatory framework more significantly threatening their positions.

However, also in this case the influence of financial industry groups has been conditional to the capacity of financial industry groups to adjust their advocacy strategies to the shift in the regulatory policymaking process towards highly politicised arenas such as the US Congress and other national parliaments. This changed institutional context has weakened the capacity of financial industry groups to counteract these proposals through their ‘tools of quiet politics’ (Culpepper 2011) such as their expertise and privileged access to decision makers, and created channels of access for the mobilisation of a number of stakeholders outside of the financial industry. As Culpepper argues in his analysis of ‘high salience’ regulatory politics (2011), the politicisation of regulatory policymaking forces the business groups to alter their advocacy strategy in order to influence public opinion in their favor, as well as to form alliances with other interest groups (Culpepper 2011: 49). These dynamics have also informed the advocacy strategies adopted by financial industry groups after the crisis, which have frequently sought to work alongside other groups in order to effectively oppose more radical changes.

crisis, credit rating agencies have jointly affirmed their commitment to amend their respective codes of conduct recommended by IOSCO (A.M Best et. al. 2008). The main banks that act as dealers in the OTC derivatives markets have coordinated an extensive set of self-regulatory measures to reinforce the operational infrastructures of these markets (discussed in Section 3 below).

² Interviews with financial industry representatives routinely express the sentiment that the volume and character of recent financial regulation is driven by elected officials’ responsiveness to perceived public demands, rather than the endogenous demands of regulators. This is also evinced by the fact that the climate of hostility toward the financial sector has been conceptually framed as the result of ‘grandstanding’ and populism (see Wearden 2009)

In order to investigate this dynamic, the next section looks beyond the financial industry in isolation and considers finance's interaction with a broader range of stakeholders that have mobilised in an attempt to shape financial regulation in the aftermath of the crisis.

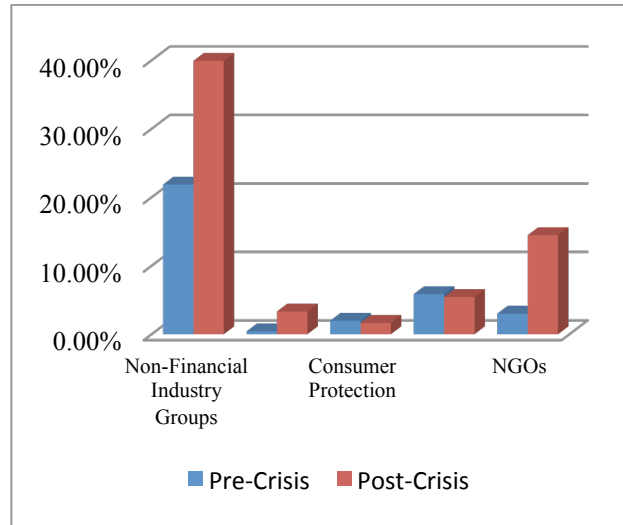
Section 2: Beyond Finance: Non-Financial End-Users and New Coalitions

Analyses of the veto players and change agents among the societal actors seeking to influence the content of financial regulatory policies have typically focused on the actors being subject to regulation, that is, financial industry groups themselves, while largely neglecting the role of other non-financial corporate actors that may be indirectly affected by such policies. Existing scholarship has posited several reasons for this narrow focus. Interest groups other than those in the financial industry have frequently been described as having neither the resources – either financial or technical expertise, nor the same incentives to mobilise and compete with financial groups in the shaping financial regulatory policies (Mattli and Woods 2009; Baker 2010). Moreover, the close ties between financial industry and regulatory agencies, strengthened by the common language, shared professional background, and revolving doors, has been described as representing an almost insurmountable barrier to the capacity of other groups to 'break in' to the relatively closed policy network of finance (Heinemann and Schüler 2002). As a result of these impediments, the presence of non-financial sector actors in shaping financial regulatory policies has been traditionally conceived as chronically weak and insignificant, with different authors who have analyzed the politics of regulatory reforms before the crisis have often lamented the lack of countervailing forces to the dominance of the financial industry (Helleiner and Porter 2010; Baker 2010)

This pervasive view does not reflect the fact that financial regulatory policymaking is actually associated with a great plurality of business groups mobilising. A quantitative indicator of the importance of non-financial sector mobilisation within financial regulatory policymaking can be found in the analysis of responses to different financial sector consultations. Figure 1 shows the results of the analysis of the private respondents

to a plurality of financial regulatory consultations across before and after the crisis, differentiating private sector respondents as a percentage of the private sector total.³

Figure 1: Different Financial Consultation Respondents, as a Percentage of Financial Industry Group Respondents



As these results illustrate, non-financial industry groups have been an important component of the mix of private sector respondent also in the period before the crisis. Most importantly, non-financial corporate actors have significantly increased their mobilisation in the financial regulatory policymaking triggered by the global financial crisis. Indeed, as a percentage of financial industry group respondents, non-financial respondents have increased by 82.6%.

These quantitative observations relate to qualitative changes in the policymaking environment. Not only has the financial crisis triggered a broader mobilisation of societal actors beyond the financial industry, but the changes in the policymaking context

³ From a selection of 146 financial sector consultations, we collected a total of 6379 private sector letters submitted to financial governance authorities at the national, regional and international levels. For each consultation, we categorized the different kinds of respondents in a given consultation. Specifically, we assessed whether or not the respondent was from within the financial sector itself, or whether the respondent was outside the financial sector. We also coded for non-profit private sector groups, such as NGOs, research institutions, labour unions, and consumer protection groups.

described above have also increased the potential receptiveness of policymakers to non-financial industry groups' concerns. As argued above, the politicisation of financial regulatory debates has weakened the incentives for elected policymakers and regulators to openly heed the requests of the financial industry. However, it has remained highly unpopular for elected policymakers to support regulatory policies that would have negatively affected corporate actors that were not at the origin of the crisis. Indeed, the importance of the impact of regulatory policies over the employment and the overall economy has been arguably increased by the change in the macroeconomic environment. As the crisis has pushed most Western countries into a recession, elected politicians have become particularly sensitive to the implications of regulation on employment and unwilling to impose costs upon corporate actors that remained a crucial source of employment.

Furthermore, the influence of corporate actors has also been magnified by the change in the institutional environment in which financial regulatory policies are developed. As argued above, the deepening of the crisis has shifted the focal point of the policymaking process from the autonomous regulatory agencies towards government branches and parliamentary committees more receptive to the claims of the non-financial groups, for example the US congressional Agriculture Committee (Clapp and Helleiner 2012).

An important question in this context is what kind of regulatory preferences non-financial industry groups have been expressing. Are they acting as a 'countervailing force' to the preferences of financial industry groups and promoting more extensive regulatory changes? Or do the two groups share similar regulatory preferences in opposing more radical regulatory changes? The situation is difficult to generalise empirically. This reflects not only the wide diversity of non-financial industry groups who have mobilised in response to post-crisis financial regulation, but also the conflicting incentives of different non-financial business groups. On the one hand, non-financial business groups have repeatedly professed their support for stronger regulatory approaches in order to mitigate the recurrence of financial crisis and their costs over the real economy. On the other hand, many of the same non-financial groups have also actively sought to mitigate

the short-term negative impact that different regulatory measures targeting financial activities would have generated over their financing and risk-management activities. Indeed, this latter set of incentives has frequently prevailed and non-financial end-users have often opposed pieces of regulations introduced primarily to curb risk in the activities of financial firms.

For instance, business groups the introduction of taxation over financial transactions that could have increased their cost of capital. According to the British Association of Corporate Treasurers, the proposal by the European Commission to tax bonds and derivatives failed ‘to recognise that these sorts of transactions and the related markets assist in the provision of capital and risk reduction for companies and as such are essential for the operation of the economy’ (ACT 2011, EACT 2012). The same corporate treasurers groups denounced how the implementation of Basel III in Europe would have ‘push[ed] upwards the overall cost of capital and make productive investment more difficult to justify financially’ (EACT 2011), while at the international level the mobilisation of non-financial industry groups against the agreement was led by the International Chamber of Commerce (ICC 2010). The opposition to the Directive presented in Europe to regulate hedge funds for the first time was not confined to the hedge fund industry but also included charitable foundations and pension funds which denounced the loss of return that the new rules would impose upon their investments (EFRP 2009, Jones 2009). The extension of scope of the Directive to venture capital funds triggered the mobilisation of 700 small and medium company managers and owners which warned the European Parliament that it would be a ‘mistake to think that its impact will be restricted to companies trading in financial instruments. This is about the real economy, and these proposals will directly affect tens of thousands of companies across every sector, from fashion to photovoltaics, and from sandwich making to waste recycling’ (Brehler, 2010). Almost 30 non-financial companies from different sectors such as retail, energy and medical research, coordinated by the US Chamber of Commerce, have mobilised to express their opposition to the ‘Volcker Rule’, that is the provision in the US legislation limiting the proprietary trading activities in the federally-

insured banking institutions on the ground that it would negatively affect their ‘ability to raise capital and manage risk’ (Abbott Laboratories et al. 2012; see Protesse 2012).

Financial interest groups have taken advantage of this mobilisation whenever possible. As argued above, the backlash against the financial industry in the US and other industrialised economies has deprived the financial industry of a number of the benefits it enjoyed in earlier times. In the place of arguments regarding the need to protect the financial sector *as such*, many financial sector groups have engaged with new financial regulatory by emphasising the ‘economy-wide’ negative effects that may result as consequence of a given regulatory policy. Examples of such advocacy behavior permeate the post-crisis political economy. For instance, shortly after the Basel III proposal was released in June 2010, the IIF responded denouncing that the implementation of the agreement would have decreased economic growth 8 times higher than estimated by the Basel Committee (IIF 2010), costing in the industrialised economies 7.5 million jobs in 5 years (IIF 2011). Rather than stressing the effects on financial institutions, or on financial markets per se, the emphasis has been on the knock-on effects of –re-regulating bank capital as exemplified in the European Banking Federations’ (EBF 2010: 2) statement that ‘[e]very Euro, Pound, or Kroner ore of core capital translates into a multiple reduction of the banks’ lending capacities.’ The Alternative Investment Managed Funds Association - the main hedge fund association in Europe - has opposed the directive presented by the European Commission by quantifying that it would have imposed a cost up to €25 billion a year on Europe’s pension fund industry. In the words of one of their advocacy documents:

With Europe facing strong demographic pressures as a result of an ageing population, pension funds will need strong growth and reliable returns over the coming years in order to meet future demand. If they suffer lower returns as a result of the directive, it’s not only Europe’s pensions funds but Europe’s pensioners of both today and tomorrow who will suffer (AIMA, 2009).

So prevalent has such a discursive turn been that important policymakers such as Bank of England’s Robert Jenkins have accused the banking industry of supporting ‘a lobbying strategy that exploits misunderstanding and fear’ in this regard (cited in Masters and Goff 2011). Simon Johnson has defined the attempts ‘to disguise this self-interest in a veneer

of social interest' as a form of 'deceptive lobbying' or 'market power masquerading as lobbying on behalf of customers' (Johnson 2011). However such behavior may be characterised, this shift in the advocacy strategy and the greater emphasis on the diffuse costs that new regulations may impose upon the economy as a whole has allowed financial industry groups to take advantage of the mobilisation non-financial end-users and to signal to the policymakers the broader support behind some of their claims.

Financial industry groups and non-financial end-users appear to have lobbied together in the formal sense only rarely. This has for instance occurred within existing cross-sectoral associations, such as the US Chamber of Commerce, which has argued in public reports for example that the new wave of US financial regulation would damage small businesses and entrepreneurship in the United States (Durkin 2009). Also in Europe the main European business association has joined the European Banking Federation and the European Federation of Retirement Provisions in jointly proclaiming that 'financial reforms should not have a disproportionate impact on growth' (BusinessEurope et al. 2010). Yet the overlap between the preferences of these two parties does appear to represent an important source of veto power in the regulatory response to the crisis.⁴ Their combined mobilisation had the impact of weakening the support for those elements of post-crisis regulatory reform seeking to more extensively challenge the dominant regulatory paradigm and interfere in the activities of financial market actors, as these proposals were frequently also those having the biggest impact over the financial intermediation towards non-financial end-users.

In the remainder of this chapter, we illustrate the importance of the mobilisation of non-financial industry groups and the attempts by financial groups to work alongside them through one of the most important post-crisis regulatory transformations: the reform of derivatives regulation in the United States.

⁴ As Baumgartner et. al. (2009) point out, for groups taking the same position to have an impact on policy outcomes, they need not be explicitly lobbying together in a formal coalition, since their signals and resources are often aggregated in 'sides' of an issue.

Section 3: Banks, Corporate End-users, and the New Politics of Derivatives Regulation

Banks and the regulation of derivatives before and after the crisis

Derivatives have become associated in the collective imaginary with the aspect of global finance most detached from the needs of the real-economy and most closely associated to 'casino' finance (Lipuma and Lee 2004) This is particularly the case for credit derivatives, the segment of derivatives markets that has witnessed the most significant growth in recent years, in which only ten banks accounted for about 90% of all the trading volumes (Kiff et. al. 2009)

Different authors who have analyzed the political economy of derivatives regulation before the crisis have therefore highlighted how the same banks that dominate these markets have in the decade before the crisis exercised a determinant influence in keeping the part of markets traded bilaterally among financial institutions - or 'over-the-counter' (OTC) - outside the direct oversight of regulatory agencies in the major jurisdictions. Working through the International Swaps and Derivatives Association (ISDA), banks which operate as derivatives dealers have over the years developed a set of self-regulatory arrangements which have made OTC derivatives markets one of the poster-child of private governance in finance (see Tsingou 2006). Moreover, when their regulatory status came to be threatened by different legislative proposals presented within the US Congress during the 1990s (Tett 2009), the threat that regulating derivatives markets could shift highly mobile derivatives trading away from New York towards London, and the importance of the financial industry as a source of political contributions (Coleman 2003) weighted heavily in dissuading US Congress from regulating the sector. In fact, the US Congress consistently rejected measures to regulate these markets and in 1999 approved the Commodity Futures Modernization Act, which formally exempted OTC derivatives markets from the oversight of federal authorities. This crucial bill was included with very little notice into an 11,000 page omnibus appropriations bill approved by the Senate on a voice vote.

Events such as the collapse of the US investment bank Lehman Brothers in September 2008, and the emergency rescue by US authorities of Bear Stearns and of the insurance giant AIG had the effects of highlighting the opaqueness and potential for systemic disruption originating from these markets. These events have also refocused the attention of policymakers towards the limits of the existing industry-driven regulatory regime built over the previous decade by derivative dealers before the crisis. Since the early stages of the crisis, derivatives dealers have reacted to this renewed scrutiny by accelerating the implementation of a wide range of self-regulatory measures coordinated during a series of closed-door meetings with the Federal Reserve Bank of New York to bolster the reinforce operational infrastructures of derivatives markets. These measures included steps to enhance the processing of derivatives traded over-the-counter, reduce the enormous volume of outstanding credit derivatives, as well as to shifting part of these markets into central clearinghouses (Federal Reserve Bank of New York 2008, 2009). This proactive engagement of derivative dealers in promoting incremental regulatory changes reflected in part the attempt to manage the regulatory risk by preserving a greater control over the emerging regulatory framework.

These initial measures were not sufficient to stem the strength of the political momentum in favor of regulation building up within the US Congress. Since the fall of 2008, different bills have been presented within Congress to tighten up the oversight of derivatives dealers by federal regulatory authorities. This included the proposal presented by the Obama administration in May 2009 to subject 'all OTC derivatives dealers and all other firms whose activities in those markets create large exposures to counterparties' to a 'robust and appropriate regime of prudential supervision and regulation', thus reversing the decision taken a decade before to exempt OTC markets from federal oversight.

While previous Congressional debates over the regulation of derivatives before the crisis had occurred, they had come 'at a time of a high degree of coordination among US regulators and private market participants' (Tsingou 2006). Yet Congressional debate during and after the recent financial crisis has been characterised by a much more adversarial tone. Derivatives dealers have complained that the US Treasury has

intentionally blindsided them in an attempt to maintain control of the legislative output, giving it almost no opportunity to review the bill presented to Congress before its publication (Harper, Leising and Harrington 2009; Derivatives Week 2009). Indeed, the backlash against Wall Street and politicisation of the debate on the regulation of derivatives created strong incentives for members of Congress to take a hard stance against derivative dealers and to oppose their claims. Even President Obama intervened in person to declare that he would veto a bill if this did not regulate severely derivative (Favole 2010) and his administration would have stood ‘firm against any attempt by the financial sector to avoid their responsibilities: in any future crisis the big financial companies must pay, not taxpayers’ (Obama 2010).

The changed political climate within Congress has significantly weakened the capacity of banks that had dominated the politics of derivatives regulation before the crisis to have their preferences secured and has forced these dealers to alter their advocacy strategy. In 1994, when different legislative proposals to regulated derivatives entered the Congressional agenda, a coalition of financial sector groups claimed that the bill was ‘unnecessary’ and that, if passed, it would increase the cost of risk management, market liquidity would decline (Brickell 1994). This time around however the changed political climate within Congress has forced financial dealers to abandon their opposition to the introduction of mandatory regulation of the sector. For instance, ISDA has immediately endorsed the legislation introduced by the US Treasury, describing this as ‘an important step toward much-needed reform of financial industry regulation’ (ISDA 2009). This does not entail that derivative dealers have not sought to scale down the scope of the legislation. On the contrary, this change in the policy advocacy has better positioned dealers to focus their lobbying on opposing proposals that would have more significantly curtailed the size of these markets and their profits, such as the attempts to force all contracts to be traded on regulated exchanges or proposals seeking to ban the so-called ‘naked’ trading of credit derivatives.

Beyond finance: the mobilisation of derivatives end-users

The shift in the regulatory process from the secretive closed-door meetings between derivative dealers and the Federal Reserve Bank of New York to the Congress had the impact of exposing derivative dealers to the competition of a broader range of financial groups. For instance, Congressional hearings gave significant space to clearinghouses and exchanges, which saw in the proposed legislation an opportunity to regain a greater share of the derivatives market (Helleiner and Pagliari 2009). Most importantly, despite the legislation introduced within Congress represented a response to the excessive risk-taking generated in the credit derivatives traded primarily among financial institutions, the broader scope of the legislation triggered an important mobilisation of groups from outside the financial sector.

The diversification of post-crisis private sector mobilisation around the area of derivatives is striking. Following the same methodology described above in Section 2, we analyzed all US hearings since 1990 which concerned the regulatory treatment of derivatives. From 48 hearings in all, we divided the private sector composition of private sector groups represented in these hearings for both the pre-crisis period and the post-crisis period, represented on Figures 2 and 3, respectively.

Figure 2: Composition of Private Sector Participants in US Congressional Hearings on Derivatives, 1990-2008

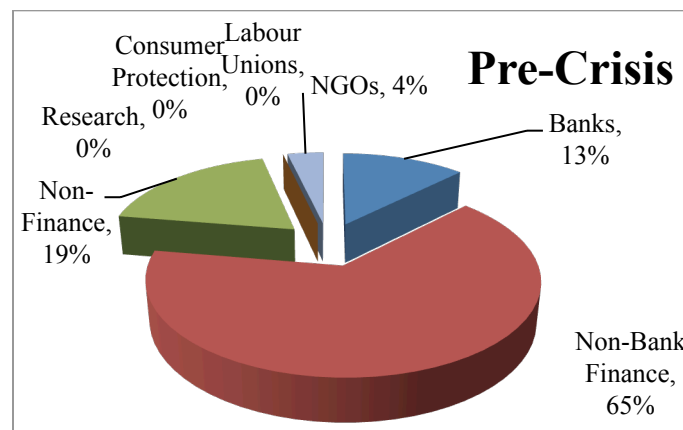
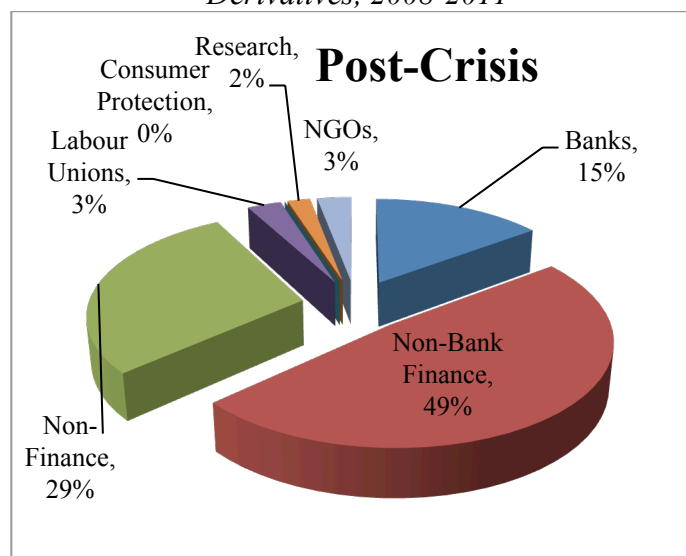


Figure 3: Composition of Private Sector Participants in US Congressional Hearings on Derivatives, 2008-2011



According to this data, non-financial sector actors have increased their presence in US congressional hearings on derivatives by 56% since the crisis. Who are these non-financial groups? One important group of non-financial actors that have mobilised in seeking to inform the regulation of derivatives is to be found in among the agricultural interests who use derivatives to hedge fluctuations in the price of agricultural products. As Clapp and Helleiner argue, US agricultural interests had been active in demanding more stringent regulations to constrain the speculative activities since the emergence of the agricultural futures markets in Chicago in the nineteenth century, but their activism and capacity to counteract the financial industry had decreased since the 1980s. Yet the role of speculation in derivatives markets in influencing commodity price volatility has meant that these agricultural interests were now again able to form a wide coalition formed by ‘producers, processors, distributors, retailers and residential, commercial and industrial end-users in the agricultural, food, and energy sectors’ named ‘Commodity Markets Oversight Coalition’. These business groups were also able to join forces with different consumer advocacy groups, NGOs the Institute for Agriculture and Trade Policy, Friends of the Earth, Public Citizen, New Rules for Global Finance), and different

faith-based organizations in support of a tighter regulation of commodity derivatives (Helleiner and Clapp 2012).

The mobilisation of non-financial business groups has not been limited to firms active in the commodity markets, however. Over 170 among the major American companies and the bulk of US peak national business associations, joined forces in a single group named ‘Coalition for Derivatives End-Users’. The letter sent to every member of Congress in October 2009 to express their concern that ‘certain proposals for reform of the OTC derivatives market would place an extraordinary burden on end-users in diverse sectors of the economy — including manufacturers, energy companies, healthcare companies and commercial real estate owners and developers (Coalition for Derivatives End-Users 2009a, see also 2009b). Table 1 lists some of the signatories within this group.

Table 1: Firm and Association Signatories to the Coalition for Derivatives End Users

<i>Individual Firms</i>	<i>Business Associations</i>
3M	Electric Power Supply Association
Ford Motor Company	American Petroleum Institute
IBM	US Chamber of Commerce
Boeing	The Business Roundtable
Caterpillar	Financial Executives International
Apple	National Association of Real Estate Investment Trusts
Intel Corporation	
Bayer	The Real Estate Roundtable
Cargill	National Association of Manufacturers
Coca-Cola	American Chemistry Council
Harley Davidson	American Gas Association
Shell Oil	American Forest and Paper Association
Procter and Gamble	Industrial Energy Consumers of America

This broad coalition claimed that the reckless and over-leveraged use of derivatives by financial institutions should not have repercussions over corporate actors who used

derivatives to reduce commercial risk and volatility in their normal business operations and end-users should not have been subject to the same requirements designed for swap dealers, in particular to process their standardised trades through central counterparties and exchanges and to post cash collateral.

The Coalition highlighted how the imposition of unilateral regulation by the US would ‘negatively impact the ability of end-users to compete in the global marketplace’ (Coalition for Derivatives End-Users 2009b). Moreover, almost half of the respondents to a survey commissioned by the Coalition stated that they would consider shifting their hedging activities to foreign jurisdictions (Keybridge Research 2011). However, more than the impact on the global competitiveness, the Coalition highlighted the impact that the new regulation would have on the real economy. In particular, they frequently claimed that the forcing central clearing and requirement of posting cash or liquid securities to serve as collateral for margin calls would have ‘would result in an extraordinary drain on working capital for American companies’ (Coalition for Derivatives End-Users 2009b), diverting liquid assets from productive activities, thus negatively impacting the capacity of firms to grow and create and maintain jobs. A survey conducted by the Coalition for Derivatives End-Users, US Chamber of Commerce, and National Association of Corporate Treasurers estimated that a ‘3% margin requirement on OTC derivatives could be expected to reduce capital spending by \$5.1 to \$6.7 billion per year, leading to a loss of 100,000 to 130,000 jobs’ within the S&P 500 companies alone (Keybridge Research 2011).

Regulatory authorities have warned that granting broad exemptions to end-users could undermine the attempt to tame the risk in derivatives markets by potentially creating loopholes that could be exploited by Wall Street (Gensler 2011). Despite this, when the legislative proposal presented by the US Treasury moved to the House of Representatives, the legislation quickly came to endorse the claims of end-users. The Dodd-Frank bill passed by Congress in the Summer of 2010 exempted ‘commercial end users’ from the registration, capital, and reporting requirements, and other rules applied to derivatives dealers and other ‘major swap participant’, as well as from the requirement

to have their derivatives transactions that are sufficiently standardised centrally cleared and traded on a regulated exchange. Corporate end users were able to win similar concessions also in the European Market Infrastructure Regulation approved in Europe.

The preferential treatment granted to corporate end-users both in the US and in Europe shows how end-users were more successful than bank lobbies in having their preferences incorporated into the legislation, which did not grant the same exemption from central clearing and exchange trading to those standardised derivatives occurring among financial institutions. How do we explain the greater influence of corporate end-users despite the greater resources mobilised by financial industry? One explanation points to the impact of the crisis in shifting the institutional context in which the regulation of derivatives took place away from institutional contexts more favorable to the financial industry, such as the series of closed-door meetings between the Federal Reserve and the main dealers, towards institutional venues that maintained stronger links with corporate end-users (e.g. Agriculture Committee and the Energy and Commerce Committee within US Congress) (see also Clapp and Helleiner 2012). But a complementary explanation points towards the electoral incentives faced by the policymakers in these venues, and the greater resonance among elected policymakers of the claims advanced by the end-users regarding the impact that regulation would have on employment vis-a-vis traditional concerns regarding a potential migration of derivatives trades from New York to London.

In a moment in which the severity of the crisis had severely tarnished their political capital in Washington, derivative dealers have adjusted their lobbying strategy to take advantage of the mobilisation of their corporate customers. Financial industry actors have followed in the footsteps of corporate end-users in highlighting the costs that the legislation would have posed severe costs not only on Wall Street but also on Main Street. For instance, the ISDA has opposed Congressional proposals to tighten the regulation of derivatives markets on the ground that they would 'increase the cost of doing business for industry participants' and 'put American businesses at a significant disadvantage to their competitors around the world' (Pickel 2009). A study published in

June 2010 argued that legislation on the table at that time would have cost US companies as much as \$1 trillion in terms of capital requirements (ISDA 2010).

The Congressional leaders who had been shepherding the legislation through Congress saw this as an attempt of 'playing on the fears of the end-users in order to obtain an exemption for themselves', as stated by Rep. Peterson (cited in Drawbaugh 2010). Barney Frank - chairman of the House Financial Services Committee and main architect of the bill in Congress - publicly expressed his concern about 'financial institutions taking the end users in effect as hostages to get out from under some of these requirements' (cited by Paletta 2010).

End-users and Wall Street: source of incremental or radical change?

We have seen that end-users of derivatives such as corporate actors have played an important role alongside 'the usual suspects' of financial industry groups. But what has been the impact that the mobilisation of end-users has actually had over the regulation of derivatives?

The greater plurality of non-financial business groups that have mobilised within Congress as well as in other policy arena has increased the challenges for the main target of the regulation, that is, banks, in limiting the scope of the re-regulation. For instance, as Clapp and Helleiner (2012) argue, the 'Commodity Markets Oversight Coalition' and the different NGOs and consumer advocacy groups that have mobilised over the regulation of commodity derivatives have successfully challenged the preferences of derivative dealers and played a key role in achieving the introduction in Dodd-Frank Act of mandatory position limits that had been resisted by financial sector groups. From the perspective of Clapp and Helleiner, non-financial end-users have been important change agent in the regulatory debate. Yet in many circumstances the advocacy of corporate end-users of derivatives has sought to restrain the scope of regulatory proposals rather than to expand them. A prominent example in this regard is the so-called 'Lincoln Amendment',

that is, the measure introduced by Senator Blanche Lincoln requiring Federally-insured banks to spin off their swaps trading desks in independently capitalised entities. This significant change in the structure of derivatives markets was supported by the different NGOs and trade unions comprising Americans for Financial Reform', which stated that this measure would 'sharply reduce the possibility of taxpayer bailouts for speculative activity that does not serve the real economy' (Americans for Financial Reform 2010). However, the corporate end-users forming the Coalition for Derivatives End-Users opposed the same proposal on the grounds that it would have made more difficult for them to find counter-parties and increased the cost of hedging their risk (Coalition for Derivatives End-Users 2010). This mobilisation contributed to watering down the extent of the measure, as subsequent legislation passed by Congress allowed banks to retain the bulk of their swap trading operations on their books, and to spin off only the trading of those derivatives perceived as riskier.

The mobilisation of corporate end-users also facilitated the attempt by derivative dealers to veto other ambitious regulatory proposals as well. For instance, different legislative proposals introduced within Congress have sought to decrease the systemic risk posed by these markets by forcing all derivatives contracts onto regulated exchanges (e.g. the 'Derivatives Trading Integrity Act of 2009', introduced in January 2009 by Senator Tom Harkin), or sought to ban the development of the most customised products (e.g. 'Credit Default Swap Prohibition Act of 2009' introduced by Representative Maxine Waters. While banks naturally opposed these measures that would have curtailed the volumes of contracts traded of the derivatives markets and barred the more profitable products, corporate end-users also opposed the same measures that would restrict their capacity to enter into customised transactions. From the perspective of the Coalition described above, the attempt to increase the safety of derivatives markets by increasing the level of standardisation would 'preclude companies from accessing customized derivatives to offset or reduce unique business risks' (Coalition for Derivatives End-Users 2009b). The legislation passed by Congress has safeguarded the capacity of financial institutions to develop and trade customised products outside of regulated exchanges.

The opposition of a broad constellation of financial and non-financial actors was also important in influencing the position of Congress over so-called ‘naked’; trading, that is, the practice of trading into derivatives without owning the underlying asset upon which the derivatives contract was based. This practice received significant attention during the crisis and different commentators have called for making this practice illegal on the ground that it represented a ‘purely speculative gamble’ without any social or economic benefit (Munchau 2008). The financier George Soros described these practices with the analogy of ‘buying life insurance on someone else’s life and owning a license to kill him’ (Soros 2009).

Congress considered different legislative proposals to ban such ‘naked’ derivatives trading and allowing only those market actors owning the underlying bond to trade in the derivatives markets (see for instance Derivatives Markets Transparency and Accountability Act of 2009’ introduced by Rep. Peterson, or the joint bill released by Peterson and the Chairman of the House Financial Services Committee Barney Frank in July 2009), but ultimately rejected this radical solution given the widespread opposition coming from beyond the banking industry. As congressman Barney Frank, the main architect of the legislation stated:

When we first began to talk about this (prohibiting naked credit default swaps)... I did not expect people in the business of selling these, people in the financial industry, to be happy with that. They weren’t ... We didn’t care whether they were or weren’t. What we began to hear were objections to some of this from those people for whom derivatives are not an end for making money as they are for the financial institutions, but a means so that they can go about their business of producing goods and services with some stability, with some reasonable expectation about cost (US House of Representatives 2009: 2).

These examples demonstrate how the significant mobilisation of corporate end-users has frequently acted not as a countervailing force to the power and preferences of the financial industry. Instead, corporate end-users have frequently expressed preferences that largely *converged* with those of financial industry groups, thus reinforcing the attempt by the financial industry to veto the introduction of more radical solutions to

regulate derivatives markets when these would have also impaired the capacity of end-users to use derivatives to hedge their commercial risks. The incremental policy change in the area of derivatives regulation can thus be attributed to a veto block of corporates and financial industry groups blocking more radical regulatory proposals.

Conclusion

As the other chapters in this volume testify, there are a wide range of explanations for why post-crisis changes to financial governance have been incremental in character. In this paper we have centered our attention on the mobilisation of private sector actors in response to financial regulatory reforms.

Through the analysis of the post-crisis attempts to reform the regulation of derivatives in the US, we have shown how incremental policy change appears to be driven in part by private sector groups, but not the usual 'Wall Street' suspects, but rather a 'Wall-Street-Main-Street' coalition. The analysis of the broader mobilisation of non-financial business groups beyond developed in Section 2 reveals how this represents a broader trend affecting the design of regulatory policies in different contexts and sectors after the crisis.

Our analysis here has not sought to challenge the notion that financial industry groups remain important societal actors in shaping financial regulatory reforms, but it calls for focused attention on two issues in any consideration of private sector roles in shaping post-crisis regulatory reform. The first is the constraints that the policymaking environment may place upon the influence of financial industry groups. From this perspective, the influence of financial industry groups has remained conditional on their capacity to adjust their advocacy strategy in order to adapt to changed environment, promoting incremental changes and tying their interests to those of other non-financial interest groups. Second, this analysis calls for greater attention to the mobilisation of non-financial industry groups in shaping financial regulatory policies and the impact that this has over the capacity of financial industry groups to shape regulatory policies. Thus We

have argued that in order to properly make sense of the role of the private sector in the incremental character of post-crisis financial regulatory change, we need to understand the broader network of private sector groups outside financial sector, and their important connections to recent regulatory changes. Ironically, when examining the impact of corporate actors as a distinct set of actors, corporate actors have frequently behaved more akin to veto players rather in the way that financial industry groups have been expected to be.

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